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The Manager
Philanthropy and Exemptions Unit
Personal and Retirement Income Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: non-commerciallosses@treasury.gov.au

Dear Sir

Exposure Draft – Non-Commercial Losses

The Taxation Institute of Australia (**Taxation Institute**) is pleased to provide comments on the exposure draft legislation (**Exposure Draft**) and the explanatory memorandum (**Explanatory Memorandum**) to implement changes announced in the 2009-10 Budget to tighten the non-commercial losses rules.

Under the current non-commercial losses rules, an individual taxpayer carrying on a business activity either alone or in partnership may only claim a loss from that activity against their other income in an income year if they satisfy at least one of four objective tests in that year (refer Explanatory Memorandum, paragraph 1.3).

Under the Exposure Draft, access to the four objective tests will be limited to individuals that satisfy an income requirement. The income requirement will be met when an individual has an adjusted taxable income of less than $250,000 in the relevant income year. If the income requirement is not satisfied, losses from non-commercial business activities are quarantined unless the Commissioner exercises his discretion.

Given that those taxpayers who do not satisfy the income requirement will be forced to rely on the Commissioner's discretion, the Taxation Institute submits that the Explanatory Memorandum should be amended to include further guidance in relation to the circumstances in which the Commissioner might be expected to exercise his discretion.

Under the Exposure Draft, the Commissioner can exercise his discretion if the income requirement is failed and:

- the business activity has started to be carried on; and
- there is an objective expectation, based on evidence from independent sources (where available) that, within a period that is commercially viable for the industry concerned, the activity will produce assessable income for an income year greater than the deductions attributable to it for that year.

The Explanatory Memorandum needs to provide guidance in relation to how the Commissioner will determine whether a business is genuinely commercial. The four objective tests are aimed at providing relief for individuals where certain characteristics of a business show that it is likely to be commercial, despite having made a loss in an income year (refer paragraph 1.11 of the Explanatory Memorandum). If access to the objective test is limited to individuals that satisfy the income requirement, there needs to be guidance on how the Commissioner will determine the commerciality of a business when the objectives tests which are suppose to be indicative of commerciality cannot be applied.

Guidance should also be provided in the Explanatory Memorandum in relation to the factors and information that will be relevant for determining whether the Commissioner will exercise his discretion. For example, guidance should be provided on whether the scale of operations will generally be sufficient or relevant in determining whether a business is genuinely commercial. Further, guidance should be provided on the impact of funding costs of the assessment of the commerciality of a business. The Taxation Institute does not consider that funding costs should be taken into account when assessing the commerciality of a business. Whether an investment is financed by debt or equity should not be relevant for the purposes of determining whether the underlying business is commercially viable.

The Explanatory Memorandum states that "weather" may be an exceptional circumstance that could be relevant in relation to the exercise of the Commissioner's discretion (refer paragraph 1.4 of the Explanatory Memorandum). Further examples of what may constitute "exceptional circumstances" should also be provided in the Explanatory Memorandum.

Lastly, guidance needs to be given on whether an application for the exercise of the Commissioner's discretion would need to be made on a yearly basis if the maximum income requirement continues to be exceeded. The Taxation Institute considers that once the Commissioner's discretion is exercised, it should apply until there is a material change in the relevant circumstances of the taxpayer or business. Otherwise, the compliance costs associated with applying to the Commissioner to exercise his discretion may be unduly restrictive.

Given the uncertainty surrounding the issues mentioned above, the Taxation Institute recommends that consideration should be given to an alternative approach to tightening the non-commercial losses rules. For example, the provisions could apply such that if the maximum income requirement is exceeded, four "modified" objective tests will apply. The modified objective tests could increase the relevant thresholds to a level considered acceptable (ie increasing the amounts required to satisfy the assessable income test, real property test and other assets test and requiring a specified minimum profit level for the profits test). The Taxation Institute considers that this approach would provide more certainty for taxpayers and mitigate the compliance costs associated with applying to the Commissioner to exercise his discretion.

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If you require any further information or assistance in respect of our submission, please contact the Taxation Institute's Senior Tax Counsel, Dr Michael Dirkis, on 02 8223 0011.

Yours sincerely

DWilliams

David Williams
Vice President